AR01

ROTHMANS OF PALL MALL CANADA LIMITED

Annual Report 1976

CONTENTS:

Head Office • 75 DUFFLAW ROAD, TORONTO, ONTARIO M6A 2W4

Auditors • PRICE WATERHOUSE & CO.

Bankers • BANK OF MONTREAL

Registrar and Transfer Agent • THE ROYAL TRUST COMPANY

Solicitors • SMITH, LYONS, TORRANCE, STEVENSON & MAYER

VALUATION DAY PRICES:

For Canadian capital gains tax purposes, the valuation day values of Rothmans of Pall Mall Canada Limited securities were as follows:

8% Debentures due January 3, 1988	$93.00
First Preferred Shares, Series A	$82.50
Second Preferred Shares	$19.88
Warrants	$ 3.50
Common Shares	$16.63

ROTHMANS OF PALL MALL CANADA LIMITED

Annual Report 1976

HIGHLIGHTS

	Twelve Months Ended	
	March 31 1976	**June 30 1975**
		(restated)
SALES	**$897,489,000**	$810,590,000
EARNINGS BEFORE EXTRAORDINARY ITEMS:		
AMOUNT	**21,084,000**	15,801,000
PER COMMON SHARE	**3.84**	2.90
DIVIDENDS PAID:		
PREFERRED SHARES	**3,604,000**	4,592,000
COMMON SHARES	**2,279,000**	1,910,000
CAPITAL EXPENDITURES	**18,880,000**	17,478,000
WORKING CAPITAL	**72,207,000**	86,764,000
TOTAL ASSETS	**424,272,000**	404,355,000
LONG TERM DEBT	**55,050,000**	59,639,000
SHAREHOLDERS' EQUITY:		
AMOUNT	**95,795,000**	88,227,000
PER COMMON SHARE	**9.18**	7.52

Ce rapport peut être obtenu en français sur demande.

Quarterly Financial Data
(in thousands of dollars)

	Twelve months ended March 31 1976	Twelve months ended June 30 1975 (restated)
CONSOLIDATED SALES:		
Quarter ended September 30	**$235,557**	$220,112
Quarter ended December 31	**232,085**	193,266
Quarter ended March 31	**197,710**	165,075
	665,352	578,453
Quarter ended June 30, 1975 (1)	**232,137**	232,137
	$897,489	$810,590

	Twelve months ended March 31 1976	Twelve months ended June 30 1975 (restated)
CONSOLIDATED EARNINGS BEFORE EXTRAORDINARY ITEMS:		
AMOUNT—		
Quarter ended September 30	**$ 5,856**	$ 3,668
Quarter ended December 31	**4,994**	3,037
Quarter ended March 31	**2,774**	1,636
	13,624	8,341
Quarter ended June 30, 1975 (1)	**7,460**	7,460
	$ 21,084	$ 15,801
PER COMMON SHARE—		
Quarter ended September 30	**$ 1.08**	$ 0.49
Quarter ended December 31	**0.90**	0.54
Quarter ended March 31	**0.41**	0.19
	2.39	1.22
Quarter ended June 30, 1975 (1)	**1.45**	1.68
	$ 3.84 (2)	$ 2.90 (3)

(1) quarter common to both twelve month periods
(2) based on 4,557,928 shares
(3) based on weighted average of 3,918,580 shares

PRINCIPAL SUBSIDIARY COMPANIES:

Rock City Tobacco Company Limited
Alfred Dunhill of London, Limited
Filtromat of Canada Limited
Carling O'Keefe Limited (50.1% owned):

CANADA
Carling O'Keefe Breweries of Canada Limited
O'Keefe Brewing Company Limited
Jordan Valley Wines Limited (91.9% owned)
Star Oil & Gas Ltd.

UNITED STATES
Carling National Breweries, Inc.
Century Importers Inc.

REPUBLIC OF IRELAND
Beamish & Crawford Limited

The Company is a member of the world-wide Rothmans Group which operates 104 plants in 26 countries and whose products are sold in more than 180 countries. Rothmans of Pall Mall Canada Limited and its subsidiary companies are engaged in the production and sale of tobacco products, beer and wine and in oil and gas operations.

The Company is Canada's second largest manufacturer and distributor of cigarettes, including such well-known brands as Rothmans King Size Filter, the Craven Family and Number 7. Fine cut tobacco and cigarette tubes are also produced and sold. Tobacco manufacturing operations are carried out at plants located in Toronto and Quebec City. The Company also sells cigarette rolling devices, imported pipe tobaccos, cigars and smokers' accessories. The Company has seventeen sales offices across Canada.

Carling O'Keefe Limited, a majority-owned (50.1%) subsidiary, operates thirteen breweries in Canada, six in the United States and one in the Republic of Ireland, producing such well-known brands as Carling Black Label, Carling Red Cap Ale, Heidelberg, Calgary Export Ale, Old Vienna, O'Keefe Ale, Tuborg, Carlsberg, Colt 45 Malt Liquor, National Premium and National Bohemian. A subsidiary company, Jordan Valley Wines Limited, produces wine at six Canadian plants. A wholly-owned subsidiary company, Star Oil & Gas Ltd., is engaged in oil and gas operations in Canada and the United States.

Directors' Report

At the last annual meeting, shareholders approved a change in the fiscal year-end of the Company from June 30 to March 31. This report, therefore, covers the nine-month fiscal period ended March 31, 1976 and, in addition, provides information for the twelve months ended on that date.

The financial highlights are outlined on the front page of this report, and reviews of the Company's and Carling O'Keefe's operations are covered on pages 6 through 9. In addition, a copy of the Carling O'Keefe annual report is enclosed to provide more detailed information on that company's consolidated operations.

As a result of higher earnings from tobacco operations and improved operating results from brewing operations, earnings before extraordinary items were 63.3 percent higher in the nine-month period. For the twelve months ended March 31, 1976, earnings before extraordinary items were 33.4 percent higher than for the twelve months ended June 30, 1975.

Total industry cigarette sales increased by 3 percent for the nine months ended March 31, 1976. The percentage figure is somewhat inflated due to advance buying by the trade prior to tobacco tax increases in a number of provinces. Your Company's unit cigarette sales continued to out-pace total industry growth and increased by 6.1 percent in the nine months ended March 31, 1976.

During the past year, two new segments were introduced into the national cigarette market—two 120 mm. length brands and one "price-off" brand. Neither segment has shown significant growth and to date your Company has not introduced products to compete in these new segments.

Following world-wide trends, the high filtration segment of the Canadian market has achieved further growth, and a number of mild cigarettes were introduced in the past year. The Company's Craven "A" brand has been a leader in this market for many years, and Dumont Select Mild was introduced in the Toronto area last fall and is now also available in Montreal and Vancouver.

The excellent reception given to the world's first flip top 25 box, introduced with Peter Stuyvesant 100's in June 1975, has led the Company to now offer this unique package design for Peter Stuyvesant 100's Menthol, Peter Stuyvesant King Size and Sportsman King Size.

Auctions of the 1975 Ontario flue-cured tobacco crop closed in May, with total sales of 210 million pounds. For the first time, prices paid at the auctions averaged less than the price guaranteed by the four major Canadian manufacturers, with the result that deficiency payments of $26.7 million are required from the four companies to bring the overall average auction price up to the minimum guarantee of 94 cents per pound. As in the past, your

Company paid above-average prices to ensure the highest quality of its tobacco products.

Effective January 1, 1976, the Canadian Tobacco Manufacturers' Council, of which Rothmans is a member, issued a revised code for the advertising and promotion of cigarettes and cigarette tobacco. The revised code expands the self-imposed regulations of 1971 which were developed in co-operation with the Department of National Health and Welfare. In addition to the ban on radio and television advertising, the limits placed on total expenditure will now include all promotional activities. These include sponsorship of sporting and cultural activities. Warning labels have been modified and will now be included in most print media, the only exception being large billboards. Sampling of cigarettes has now been eliminated except for new brands at the point of purchase. An independent Board has been established to ensure compliance. By the adoption of this revised code, the Canadian tobacco industry has shown its continued willingness to co-operate with Government officials. The Canadian code includes most of the restrictions which other countries have imposed by legislation while still allowing the individual companies to remain competitive in the marketplace.

Excluding extraordinary items, Carling O'Keefe Limited incurred a lower operating loss in 1976. On October 31, 1975, the United States brewing subsidiary of Carling O'Keefe acquired the brewing assets and trademarks of The National Brewing Co. Subsequent to that date, steps were taken to re-organize United States brewing operations, including the closure of the plant at Natick, Massachusetts and the combination of certain administrative and marketing functions. A provision of $3,363,000 has been charged as an extraordinary item for costs relating to these actions. Negotiations for orderly disposal of the Natick plant and property are now in progress. No adjustment to the recorded value of this asset has been reflected, pending its final disposition.

On October 13, 1975, the Canadian government introduced a program of price, profit, dividend and compensation controls. Rothmans and Carling O'Keefe have now filed initial reports, with future reports required on a quarterly basis. It is clear that your Company will have considerably less operating flexibility during the period that the controls remain in effect.

It was with a deep sense of loss that directors and management noted the passing of Mr. Frederick L. Patterson on December 25, 1975. Mr. Patterson had served as a director of the Company from 1968 until the date of his death. Mr. C. Paul Young, Vice President, General Counsel and Secretary of the Company, has been elected to fill the vacancy on the Board.

On behalf of my fellow directors, I wish to express appreciation to all employees of the Company and its subsidiaries, and to thank our shareholders for their loyal support.

John H. Devlin

May 21, 1976 *Chairman of the Board*

Review of Tobacco Operations

As indicated previously, the Company changed its fiscal year-end from June 30 to March 31 in 1976. In this review section, comparisons are made between the two twelve-month periods ended March 31, 1976 and June 30, 1975, both of which include the quarter ended June 30, 1975.

TWELVE MONTHS ENDED	MARCH 31 1976	JUNE 30 1975	INCREASE
SALES	$385,406,000	$344,134,000	12.0%
EARNINGS			
Before income taxes	37,578,000	30,648,000	22.6
After income taxes	21,729,000	17,328,000	25.4

Record levels of sales and earnings were again achieved in tobacco operations during the twelve months ended March 31, 1976. Furthermore, an increase in the Company's share of the Canadian cigarette market was also realized.

Sales:

The significant improvement in sales revenue was primarily due to selling price increases obtained during the previous fiscal year and higher unit cigarette sales.

(i) Cigarette division—
Sales revenue for this division increased by 12.2 percent to $372,448,000, from $332,095,000 in 1975. The full impact of price increases effective September 30, 1974 and April 16, 1975 (to offset higher manufacturing costs) and December 2, 1974 (to recover additional federal excise duty and sales tax) are reflected in the 1976 figures. These increases had only a partial effect on revenues for the 1975 fiscal year.

The Company's unit cigarette sales rose to 17,050 million from 16,321 million in 1975, an increase of 729 million or 4.5 percent. Sales for the year were somewhat inflated by advance purchases by the trade in March, 1976 prior to anticipated tobacco tax increases in certain provinces.

The gain in unit sales resulted primarily from higher volumes for Rothmans King Size Filter, the Craven Family, Number 7 and Peter Stuyvesant 100's. The Craven Family achieved an overall sales growth of 7.2 percent during the period, with Craven King Size up by 11.5 percent and Craven Menthol by 6.6 percent; Craven "A" sales volume was virtually unchanged. Number 7, despite limited marketing support, maintained its growth pattern and realized a unit sales increase of 7 percent over 1975. Peter Stuyvesant 100's had a very significant percentage unit sales increase, although over a relatively small base. Rothmans King Size Filter attained a growth of 2.3 percent and continued to be Canada's largest selling king size cigarette.

Industry cigarette sales grew by 2.2 percent compared to the 1975 fiscal year (to 59,679 million from 58,385 million last year). The Company's share of total industry sales increased to 28.6 percent from 28.0 percent. During the ten years ended March 31, 1976, the Company's unit cigarette sales gained 84.8 percent compared to an industry growth of 34.4 percent.

During the past year, the Company introduced three new brands—Peter Stuyvesant 100's Menthol, Richelieu Satin Tip and Dumont Select Mild. Because of the excellent acceptance given to the flip top 25 pack introduced with Peter Stuyvesant 100's in June, 1975, the Company now additionally offers Peter Stuyvesant 100's Menthol, Peter Stuyvesant King Size and Sportsman King Size in this unique package design.

At the present time, the Company's active brands are as follows:

REGULAR	KING SIZE	LUXURY LENGTH
Filter:	*Filter:*	*Filter:*
Craven "A"	Rothmans	Peter Stuyvesant 100's
Sportsman	Number 7	Peter Stuyvesant 100's Menthol
Black Cat	Craven King Size	
	Craven Menthol	
	Sportsman	
	Perilly's Private Blend	
	Peter Stuyvesant	
Plain:	Richelieu Satin Tip	
Sportsman	Dunhill	
Black Cat	Dumont Select Mild	

(ii) Fine Cut division—
Sales revenue from domestic tobacco, cigarette tubes and cigarette rolling devices increased by 3 percent to $8,596,000, from $8,346,000 in the 1975 fiscal year. The gain was due in part to increased selling prices for domestic tobacco (December 2, 1974 to recover additional federal taxes and April 16, 1975 to offset increased costs) which had a full year's impact on 1976 revenues compared to only a partial effect in 1975. Unit sales of domestic fine cut and pipe tobacco increased by 2.1 percent to 1,762,000 pounds from 1,725,000 pounds in 1975.

The Company's share of the total Canadian industry sales of fine cut tobacco increased to 11.9 percent from 11.6 percent last year. Total unit sales of cigarette tubes and cigarette rolling devices were lower than in 1975.

(iii) Dunhill division—
Sales revenue from imported pipe tobacco, cigars and smokers' accessories for the twelve months ended March 31, 1976 amounted to $4,362,000, an increase of 18.1 percent from $3,693,000 last year. Unit sales of cigars were significantly higher, while volumes for pipe tobacco and pipes were virtually unchanged from 1975. Total unit sales of lighters showed a decline during the period under review.

Earnings before Income Taxes:

	Twelve Months Ended	
	March 31 1976	June 30 1975
Sales	100.0%	100.0 %
Excise and sales taxes	56.2	57.2
Net sales	43.8	42.8
Costs:		
Raw materials and manufacturing	24.1	23.9
Marketing and distribution	6.3	6.3
Administrative and general	2.1	2.0
Interest	1.5	1.7
	34.0	33.9
Earnings before income taxes	9.8%	8.9%

(i) Excise and sales taxes—
Excise duty, excise tax and sales tax, all federally imposed, are the taxes included in this category. Compared to the 1975 fiscal year, these costs increased by $19,801,000 or 10.1 percent during the twelve months ended March 31, 1976.

There were no changes in duty or tax rates during the period under review. These taxes presently represent 25.5 cents and 31.8 cents per pack of 20 and 25 king size cigarettes respectively.

In addition to the above-noted federal taxes, all provinces and territories of Canada levy tobacco taxes. During the twelve months ended March 31, 1976, four provinces (British Columbia, Saskatchewan, Nova Scotia and Prince Edward Island) increased their tobacco taxes and Newfoundland effectively increased its tax per pack by an amendment to its Retail Sales Tax Act. Subsequent to March 31, Ontario, Manitoba, Quebec and the Yukon Territory increased tobacco taxes, so that, in a period of slightly more than one year, nine out of a total of twelve provinces and territories raised their taxes. Provincial taxes on cigarettes are now as follows:

PER PACK OF:	*20's*	*25's*
British Columbia	9.6¢	12.0¢
Alberta	6.4	8.0
Saskatchewan	12.0	15.0
Manitoba	16.0	20.0
Ontario	14.2	17.8
Quebec	16.0	20.0
New Brunswick	8.0	10.0
Nova Scotia	10.0	12.5
Prince Edward Island	16.0	20.0
Newfoundland	29.0	36.0
Yukon Territory	12.0	15.0
Northwest Territories	6.4	8.0

For a package of cigarettes in Canada, federal and provincial taxes together now range from 165 to 295 percent of the manufacturers' selling price excluding taxes.

(ii) Raw materials and manufacturing expenses—
This category consists of direct manufacturing costs (leaf tobacco, wrapping materials and direct labour) and indirect or overhead expenses. In total, these costs increased by $10,587,000 or 12.9 percent over 1975, with all elements increasing on a per unit basis.

Leaf tobacco costs charged against earnings during the twelve months ended March 31, 1976 amounted to $1.06 per pound, compared to 98 cents last year.

Auctions of the 1975 Ontario flue-cured leaf tobacco crop commenced on October 27, 1975. The auctions closed on May 14, 1976 with sales totalling 210 million pounds compared to 238 million pounds last year. The

average price paid during the auctions was 81 cents per pound. However, the Canadian tobacco manufacturers had guaranteed an overall auction price of 94 cents per pound and the deficiency of 13 cents per pound (totalling $26.7 million) must be contributed by the four major companies on a pro rata basis; Rothmans' share is approximately 25 percent. To ensure its standards of quality tobacco, the Company continued its policy of paying above-average prices. The Company's cost for Ontario leaf averaged $1.09 per pound, compared to 92 cents last year.

The 1976 Ontario crop to be harvested this autumn is expected to yield approximately 175 million pounds.

The Company also purchases leaf tobacco in the Province of Quebec and in the Maritimes. For the 1975 crop, these purchases amounted to approximately 28 percent of the total available for sale in these two areas.

Excluding payments made on account of 1975 crop purchases, at March 31, 1976 inventories of redried tobacco totalled 31.2 million pounds valued at an average cost of $1.19 per pound.

Wrapping materials are the second most significant element of production cost. Further increases in suppliers' prices were experienced during the period under review, thereby increasing unit costs. However, the rate of increase was somewhat lower than the extremely rapid escalation which had been experienced during the previous two years.

Direct labour costs per unit of production were higher than in the previous year. Labour contracts expired December 20, 1975 at Toronto and March 19, 1976 at Quebec. At the time of writing this report, a new Toronto agreement was under review by the Anti-Inflation Board.

Indirect manufacturing costs rose significantly during the period. On a per unit of production basis, the increase was somewhat modified by higher production volume.

(iii) Marketing and distribution expenses—
Selling, advertising, freight and warehousing costs rose by $2,652,000 or 12.3 percent over 1975, with all categories showing increases. Higher marketing costs (selling and advertising) reflected increased costs of salaries and fringe benefits, media advertising, promotion activities and point of sale material, partially offset by reduced expenditures on public relations and special events.

Freight costs were up as a result of both increased volume and higher freight rates. Warehousing cost increases reflected primarily higher salary, fringe benefit and building operating costs.

(iv) Administrative and general expenses—
Compared to the year ended June 30, 1975 these expenses increased substantially. A significant factor was the write-off of amounts spent on a variety of research and development projects. Also, profits realized on the disposal of property, plant and equipment and on the purchase of debentures for sinking fund purposes were significantly lower than last year.

(v) Interest expense—
Interest expense on both long and short term debt was $112,000 lower than in 1975. This decrease resulted primarily from lower average interest rates on short term borrowings. Although the prime bank rate increased from 9% at the beginning of the period to 10¼% in the latter part of the period (compared to a decrease from 11½% to 9% during 1975), the weighted average rate for the period was lower than last year. Partially offsetting this decrease were generally higher levels of borrowing during the 1976 period.

Income Taxes:
Income taxes charged against earnings for the twelve months ended March 31, 1976 amounted to $15,849,000 or 42.2 percent of earnings before tax (1975—$13,320,000; 43.5 percent). The rate decrease primarily reflects the introduction of the federal 5% investment tax credit in June, 1975 and the discontinuance of the 10% federal surtax effective April 30, 1975.

The Company accounts for income taxes on the tax allocation basis for all timing differences between accounting and taxable income, the major difference being the excess of capital cost allowance claimable for income tax purposes over depreciation recorded in the accounts.

Capital Expenditures:
Expenditures on property, plant and equipment amounted to $8,999,000 during the twelve months ended March 31, 1976, compared to $6,026,000 in the 1975 fiscal year. Major expenditures related to additional and replacement production equipment and the replacement of company vehicles. Depreciation expense for the twelve months was $3,423,000 (1975—$3,190,000).

Review of Brewing Operations

As in other sections of this report, comparisons are made between the two twelve-month periods ended March 31, 1976 and June 30, 1975 (in which the quarter ended June 30, 1975 is common).

The Company's majority-owned subsidiary, Carling O'Keefe Limited, incurred further operating losses during the nine and twelve months ended March 31, 1976, as a result of the continuation of losses in United States brewing operations. However, the overall operating loss of 5.9 cents per Carling O'Keefe common share during the twelve months was lower than the restated loss of 14.0 cents incurred during the 1975 fiscal year, due to improved earnings from Canadian brewing, wine and oil and gas operations. During 1976, the oil and gas subsidiary retroactively changed its basis of accounting from the "conventional" to the "full cost" method. As a result, the Carling O'Keefe consolidated loss was reduced by 5.5 cents per share in 1976 and by 3.3 cents in 1975.

Effective October 31, 1975, the major United States subsidiary acquired the brewing assets and trademarks of The National Brewing Co. Subsequent to that date, steps were taken to re-organize the United States operations, including the closure of the Natick, Massachusetts plant and the combination of certain administrative and marketing functions. A provision of $3,363,000 (15.5 cents per common share) has been charged against earnings as an extraordinary item for costs relating to these actions, increasing the total consolidated 1976 loss to 21.4 cents. There were no extraordinary items during the 1975 fiscal year.

Consolidated sales were $512,083,000 for the twelve months ended March 31, 1976, an increase of 9.8 percent over 1975. Higher sales revenue was realized in all areas of Carling O'Keefe's operations.

Sales revenue from Canadian brewing operations was $287,237,000 compared to $272,516,000 in 1975, an increase of 5.4 percent. The major factors were selling price increases received in certain provinces during the 1976 period and the full period impact of increases received in the prior year. Sales volume was relatively unchanged at 4,313,000 barrels (1975—4,330,000 barrels). Earnings from Canadian brewing operations increased to $6,166,000 from $4,575,000 last year.

United States brewing operations achieved sales of $171,156,000 compared to $146,029,000 in 1975, a gain of 17.2 percent. The major factor was the inclusion of sales of National brands for the five-month period November 1, 1975 to March 31, 1976. Total sales volume for the twelve months was 3,677,000 barrels compared to 3,421,000 barrels in 1975. Excluding the costs of re-organization referred to previously, the loss incurred on United States brewing operations was $9,960,000 compared to $9,436,000 for the 1975 fiscal year.

Sales revenue from brewing operations in the Republic of Ireland amounted to $18,830,000, an increase of 8.8 percent from 1975 sales of $17,314,000. Sales volume of 200,000 barrels was virtually unchanged from last year's 199,000 barrels. Earnings declined to $116,000 from $246,000 in 1975.

Jordan Valley Wines Limited and its subsidiaries attained consolidated sales of $30,019,000, up by 9.9 percent from sales of $27,317,000 last year. Sales volume also increased, from 4,698,000 gallons in 1975 to 4,891,000 gallons in 1976. Carling O'Keefe's share (91.9%) of Jordan's earnings amounted to $1,199,000, compared to $842,000 (83.8%) in 1975.

Oil and gas operations (Star Oil & Gas Ltd.) realized sales of $4,841,000 in 1976, up 47.6 percent from last year's $3,280,000. Earnings were $2,324,000 compared to $932,000 (restated) in 1975.

Royalty income from the sales of Carling Black Label under franchise agreements in the United Kingdom and Africa amounted to $1,381,000 in 1976, an increase of 18.4 percent over the 1975 fiscal year.

For further information on brewing operations, reference should be made to the enclosed 1976 annual report of Carling O'Keefe Limited.

Line of Business Data

(in thousands of dollars)

CONSOLIDATED OPERATING RESULTS	Nine months ended March 31 1976 (Note 2)	Twelve months ended March 31 1976	Twelve months ended June 30 1975 (restated)
INCOME:			
Sales—			
Tobacco	$288,960	$385,406	$344,134
Brewing	376,392	512,083	466,456
	665,352	897,489	810,590
Excise and sales taxes—			
Tobacco	161,739	216,627	196,826
Brewing	111,795	154,789	149,419
	273,534	371,416	346,245
Investment and other income—Brewing	2,551	3,678	3,575
Foreign exchange gain (loss)—Brewing	(607)	(651)	60
COSTS:			
Tobacco—			
Raw materials and manufacturing	70,238	92,736	82,149
Marketing and distribution	18,767	24,297	21,645
Administrative and general	6,750	8,255	6,841
Interest and expense on long term debt	2,296	3,084	1,728
Other interest	1,973	2,829	4,297
	100,024	131,201	116,660
Brewing—			
Raw materials and manufacturing	179,850	238,220	210,079
Marketing and distribution	68,387	93,647	88,216
Administrative and general	14,707	19,496	17,105
Interest on long term debt	1,180	1,584	1,694
Other interest	1,580	2,086	1,809
	265,704	355,033	318,903
	365,728	486,234	435,563
EARNINGS BEFORE INCOME TAXES:			
Tobacco	27,197	37,578	30,648
Brewing	837	5,288	1,769
	28,034	42,866	32,417
INCOME TAXES:			
Tobacco—			
Current	10,429	14,283	12,117
Deferred	1,038	1,566	1,203
	11,467	15,849	13,320
Brewing—			
Current	2,553	3,219	1,096
Deferred	794	1,056	1,409
	3,347	4,275	2,505
	14,814	20,124	15,825
EARNINGS (LOSS) BEFORE MINORITY INTEREST AND EXTRAORDINARY ITEMS:			
Tobacco	15,730	21,729	17,328
Brewing	(2,510)	1,013	(736)
	$ 13,220	$ 22,742	$ 16,592

The line of business data on pages 10 and 11 is an integral part of the consolidated financial statements.

Line of Business Data

(in thousands of dollars)

CONSOLIDATED FINANCIAL POSITION

INVENTORIES:	March 31 1976 (Note 2)	June 30 1975 (restated)
Tobacco:		
Leaf tobacco	**$ 37,185**	$ 62,803
Advances on leaf tobacco purchases	**33,396**	—
Finished stock	**22,900**	23,371
Packaging material and other	**6,755**	4,583
	100,236	90,757
Brewing:		
Beverage products, finished and in process	**33,336**	29,955
Materials and supplies	**15,799**	14,840
Containers	**11,870**	11,728
	61,005	56,523
	$161,241	$147,280

PROPERTY, PLANT AND EQUIPMENT:

	March 31 1976 Cost	March 31 1976 Accumulated depreciation	June 30 1975 Cost	June 30 1975 Accumulated depreciation
Tobacco:				
Land	**$ 2,260**	**$ —**	$ 2,243	$ —
Buildings	**5,411**	**2,344**	5,312	2,237
Machinery, furniture and fixtures	**37,289**	**19,300**	32,108	17,879
Motor vehicles	**4,467**	**2,254**	4,074	1,807
Leasehold improvements	**6,250**	**3,278**	5,157	2,671
	55,677	**27,176**	48,894	24,594
Brewing:				
Land	**6,875**	**—**	6,431	—
Buildings	**86,828**	**29,939**	82,007	29,353
Machinery and equipment	**147,525**	**91,829**	140,361	89,794
Motor vehicles	**14,526**	**6,870**	13,392	6,115
Oil and gas properties	**17,935**	**3,311**	17,357	2,886
Leasehold improvements	**1,482**	**719**	2,123	819
	275,171	**132,668**	261,671	128,967
	$330,848	**$159,844**	$310,565	$153,561

BANK INDEBTEDNESS AND NOTES PAYABLE:	March 31 1976	June 30 1975
Bank indebtedness:		
Tobacco	**$31,920**	$27,102
Brewing	**30,145**	9,945
	62,065	37,047
Notes payable:		
Tobacco	**15,450**	14,115
Brewing	**—**	5,000
	15,450	19,115
	$77,515	$56,162

LONG TERM DEBT (consisting of Sinking Fund Debentures):	March 31 1976	June 30 1975
Rothmans of Pall Mall Canada Limited:		
Series A 8% due January 3, 1988	**$10,100**	$10,506
Series B 11% due February 15, 1995	**19,100**	19,900
	29,200	30,406
Carling O'Keefe Limited:		
Series A 4¾% due January 15, 1979	**1,482**	1,954
Series B 4¼% due January 15, 1981	**3,478**	3,586
Series C 5% due January 15, 1983	**3,954**	4,093
Series D 5½% due April 1, 1986	**7,684**	7,760
Series E 5½% due April 1, 1989	**12,865**	12,949
	29,463	30,342
	58,663	60,748
Less: Amount included in current liabilities	**3,613**	1,109
	$55,050	$59,639

Consolidated Statement of Earnings

(in thousands of dollars)

	Nine months ended March 31 1976	Twelve months ended March 31 1976	Twelve months ended June 30 1975
	(Note 2)		(restated)
Income:			
Sales	**$665,352**	**$897,489**	$810,590
Excise and sales taxes	**273,534**	**371,416**	346,245
	391,818	**526,073**	464,345
Investment and other income	**2,551**	**3,678**	3,575
Foreign exchange gain (loss)	**(607)**	**(651)**	60
	393,762	**529,100**	467,980
Costs (Notes 13 and 14):			
Raw materials and manufacturing	**250,088**	**330,956**	292,228
Marketing and distribution	**87,154**	**117,944**	109,861
Administrative and general	**21,457**	**27,751**	23,946
Interest and expense on long term debt	**3,476**	**4,668**	3,422
Other interest	**3,553**	**4,915**	6,106
	365,728	**486,234**	435,563
	28,034	**42,866**	32,417
Income taxes (Note 15):			
Current	**12,982**	**17,502**	13,213
Deferred	**1,832**	**2,622**	2,612
	14,814	**20,124**	15,825
	13,220	**22,742**	16,592
Minority interest (Note 10)	**404**	**(1,658)**	(791)
Earnings before extraordinary items	**13,624**	**21,084**	15,801
Extraordinary items:			
Provision of $3,363 for cost of re-organization of United States brewing operations, less minority interest of $1,678 (Note 6)	**(1,685)**	**(1,685)**	–
Excess cost of Carling O'Keefe shares written off (Note 11)	**–**	**(71,570)**	(71,570)
	(1,685)	**(73,255)**	(71,570)
Earnings (loss) for the period	**$ 11,939**	**$(52,171)**	$(55,769)
Earnings (loss) per Common share (Note 16):			
Before extraordinary items	**$ 2.39**	**$ 3.84**	$ 2.90
After extraordinary items	**$ 2.02**	**$ (12.24)**	$ (15.36)

Consolidated Statement of Retained Earnings

(in thousands of dollars)

	Nine months ended March 31 1976	Twelve months ended March 31 1976	Twelve months ended June 30 1975
	(Note 2)		(restated)
Balance at beginning of period (Note 4)	**$ 30,807**	**$ 24,753**	$ 21,364
Earnings (loss) for the period	**11,939**	**(52,171)**	(55,769)
Transfer of excess cost of Carling O'Keefe shares written off, applied against reduction in capital in 1976 (Note 11)	**—**	**71,570**	71,570
Excess of par value over cost of First Preferred shares purchased for cancellation (Note 11)	**3**	**47**	69
Excess of par value over cost of preference shares purchased for cancellation by Carling O'Keefe Limited, less minority interest	**48**	**68**	75
	42,797	**44,267**	37,309
Dividends paid:			
Preferred shares—			
First Preferred shares, Series A	**873**	**1,163**	1,173
Second Preferred shares	**1,831**	**2,441**	2,773
Third Preferred shares	**—**	**—**	646
	2,704	**3,604**	4,592
Common shares	**1,709**	**2,279**	1,910
	4,413	**5,883**	6,502
Balance at end of period	**$ 38,384**	**$ 38,384**	$ 30,807
Dividends paid per share:			
First Preferred	**$5.13¾**	**$6.85**	$6.85
Second Preferred	**0.99⅜**	**1.32½**	1.32½
Third Preferred	**—**	**—**	0.33⅛
Common	**0.37½**	**0.50**	0.50

Consolidated Statement of Changes in Financial Position

(in thousands of dollars)

	Nine months ended March 31 1976	Twelve months ended March 31 1976	Twelve months ended June 30 1975
	(Note 2)		(restated)
Working capital was increased by:			
Earnings before extraordinary items	$ 13,624	$ 21,084	$ 15,801
Depreciation	10,764	14,159	13,471
Minority interest in earnings before extraordinary items	(404)	1,658	791
Other items not requiring working capital	2,315	2,113	1,517
Working capital from operations	26,299	39,014	31,580
Proceeds on disposal of—			
Property, plant and equipment	1,025	1,865	1,185
Other assets	1,545	2,848	3,881
Issue of long term debt (Note 9)	—	—	20,000
	28,869	43,727	56,646
Working capital was decreased by:			
Purchase of assets of The National Brewing Co. for $18,952, less working capital of $5,919 (Note 5)	13,033	13,033	—
Purchase of additional shares of Jordan Valley Wines Limited (Note 5)	2,397	2,397	—
Provision for cost of re-organization of United States brewing operations (Note 6)	3,363	3,363	—
Property, plant and equipment additions	14,013	18,880	17,478
Reduction of long term debt	4,385	4,782	4,358
Dividends on Preferred shares	2,704	3,604	4,592
Dividends on Common shares	1,709	2,279	1,910
Dividends paid by subsidiary companies to minority shareholders	1,700	2,234	2,221
Purchase of First Preferred shares	6	99	134
Discount and expense on long term debt	—	—	520
Other	116	173	158
	43,426	50,844	31,371
Increase (decrease) in working capital	(14,557)	(7,117)	25,275
Working capital at beginning of period	86,764	79,324	61,489
Working capital at end of period	$ 72,207	$ 72,207	$ 86,764

Consolidated Balance Sheet

(in thousands of dollars)

	March 31 1976 (Note 2)	June 30 1975 (restated)
ASSETS		
Current assets:		
Cash	**$ 2,562**	$ 6,474
Short term investments, at the lower of cost and market	**347**	2,347
Accounts receivable	**50,733**	55,867
Recoverable income taxes	**1,988**	888
Inventories	**161,241**	147,280
Prepaid expenses	**4,638**	4,941
Total current assets	**221,509**	217,797
Property, plant and equipment, at cost	**330,848**	310,565
Less: Accumulated depreciation	**159,844**	153,561
	171,004	157,004
Other assets (Note 7)	**31,759**	29,554
	$424,272	$404,355
LIABILITIES		
Current liabilities:		
Bank indebtedness (Note 8)	**$ 62,065**	$ 37,047
Notes payable	**15,450**	19,115
Accounts payable and accrued liabilities	**46,833**	45,466
Income taxes	**4,274**	6,723
Excise, sales and other taxes	**20,149**	22,148
Dividends payable to minority interest	**531**	534
Total current liabilities	**149,302**	131,033
Long term debt (Note 9)	**55,050**	59,639
Other long term obligation (Note 5)	**2,424**	—
Total liabilities	**206,776**	190,672
DEFERRED INCOME TAXES	**22,384**	20,552
MINORITY INTEREST IN SUBSIDIARY COMPANIES (Note 10)	**99,317**	104,904
SHAREHOLDERS' EQUITY		
Capital stock (Note 11):		
Preferred shares	**53,821**	53,830
Common shares	**3,590**	75,160
	57,411	128,990
Excess cost of Carling O'Keefe shares written off (Note 11)	**—**	(71,570)
	57,411	57,420
Retained earnings (Notes 12 and 18)	**38,384**	30,807
Total shareholders' equity	**95,795**	88,227
	$424,272	$404,355

APPROVED BY THE BOARD:

JOHN H. DEVLIN, *Director*

ROBERT H. HAWKES, *Director*

Notes to Consolidated Financial Statements

MARCH 31, 1976 AND JUNE 30, 1975

1. Summary of significant accounting policies:

PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. Purchase accounting has been followed for all acquisitions and the results of operations of subsidiaries are included from effective dates of acquisition.

For certain brewing subsidiaries acquired prior to April 1, 1974, the excess of the cost of shares over the recorded value of underlying net tangible assets at dates of acquisition is carried at cost and is not being amortized. In accordance with current accounting practice, intangible assets acquired subsequently are being amortized over periods not exceeding forty years.

FOREIGN EXCHANGE:

Foreign currency accounts are translated to Canadian dollars as follows: current accounts at exchange rates in effect at the end of the period; other balance sheet accounts and depreciation expense at historical rates; income and other costs at average rates for the period. The resulting exchange gains or losses are included in the consolidated statement of earnings.

INVENTORIES:

Except for containers, inventories are stated at the lower of average cost and net realizable value. Containers are recorded at amortized cost which is lower than new replacement cost.

PROPERTY, PLANT AND EQUIPMENT:

Depreciation is recorded generally on the straight-line basis over the estimated service lives of the assets, which are as follows for the principal asset categories:

Buildings—15 to 50 years
Machinery, furniture and fixtures—5 to 20 years
Motor vehicles—3 to 10 years
Leasehold improvements—term of lease, not to exceed 10 years

Oil and gas properties are accounted for on the full cost method, whereby all costs of exploration and development are capitalized and amortized against income using the unit of production method based on proven oil and gas reserves.

OTHER ASSETS:

Other assets are recorded at cost or amortized cost except for those held for resale, which are recorded at estimated realizable value if less than cost or amortized cost.

PENSIONS:

Current service costs are charged to operations as they accrue. Prior service costs arising from amendments to the plans and actuarial gains and losses are charged to operations as they are funded in accordance with legal requirements over periods ranging from five to thirty years. The liability for unfunded vested benefits recorded on the acquisition of the assets of The National Brewing Co. is being amortized over approximately eighteen years.

RESEARCH AND DEVELOPMENT:

Research and development expenditures are charged to operations as incurred.

MARKETING:

Marketing costs, including those related to the introduction of new brands, are charged to operations as incurred, except for certain promotional items which are charged to operations as used.

INCOME TAXES:

Income taxes are accounted for on the tax allocation basis for all timing differences between accounting and taxable income.

EARNINGS PER COMMON SHARE:

The calculation of earnings per share figures shown on the consolidated statement of earnings is based on the weighted average number of Common shares outstanding during the period. Dividends earned on the Preferred shares are deducted from consolidated earnings for purposes of this calculation.

2. Change in fiscal year-end:

The Company and its subsidiaries changed their fiscal year-end from June 30 to March 31, effective in 1976, to conform with the world-wide Rothmans Group.

3. Line of business reporting:

In these statements, all references to "brewing" relate to all activities of the Company's majority-owned (50.1%) subsidiary, Carling O'Keefe Limited, which include the production and sale of beer and wine and also the oil and gas operations. Details by line of business of consolidated operating results and certain consolidated assets and liabilities are shown on pages 10 and 11.

4. Accounting change:

Brewing management has decided to pursue a more active exploration programme in Star Oil & Gas Ltd., for which it believes the full cost method of accounting is more appropriate. Accordingly, as at March 31, 1976, the method of accounting for oil and gas operations was changed from the "conventional" to the "full cost" method. Under the previous method, property carrying costs and unsuccessful exploration costs were charged to expense as incurred and the cost of abandoned properties was written off. Under the full cost method, all costs of exploration and development are capitalized and amortized over the production of proven oil and gas reserves. This change, which has been adopted retroactively, increased earnings for the nine and twelve-month periods ended March 31, 1976 by $381,000 (after minority interest of $380,000) and $606,000 (after minority interest of $603,000) respectively, and by $365,000 (after minority interest of $364,000) in 1975. Retained earnings at July 1, 1974 have been increased by $105,000 (after minority interest of $104,000).

5. Acquisitions:

Effective October 31, 1975, the major United States subsidiary of Carling O'Keefe acquired for cash the brewing assets and trademarks of The National Brewing Co. and assumed long term liabilities for unfunded vested prior service pension benefits. The values established by the transaction were as follows:

Property, plant and equipment	$13,586,000
Trademarks	1,899,000
	15,485,000
Long term pension obligation for vested benefits	2,452,000
	13,033,000
Working capital items	5,919,000
	$18,952,000

Additional consideration, up to a maximum of U.S. $9 million, may be payable under a formula based on the earnings of the major United States brewing subsidiary over the seven-year period commencing April 1, 1976.

Effective August 31, 1975, in accordance with the terms of previous acquisition agreements, Carling O'Keefe acquired an additional 17,241 common shares (8.1%) of Jordan Valley Wines Limited for $2,397,000 cash, of which $726,000 represented the excess cost of the shares over the value of the underlying net tangible assets.

6. Cost of re-organization of United States brewing operations:

Subsequent to the acquisition of the brewing assets of The National Brewing Co. on October 31, 1975, steps were taken to re-organize the United States brewing operations. These included the closure of the plant at Natick, Massachusetts during May, 1976 and the combination of certain administrative and marketing functions. A provision of $3,363,000 has been made for costs relating to these actions. No adjustment has been made to the recorded value of the Natick plant of $4,936,000 at March 31, 1976, pending final disposition of the property. Negotiations for orderly disposal are now in progress.

7. Other assets:

	March 31 1976	June 30 1975
Unamortized cost of shares of Carling O'Keefe subsidiaries in excess of underlying net tangible asset values at acquisition	$12,618,000	$11,902,000
Trademarks and patents, less amortization	2,218,000	315,000
Sundry properties	8,274,000	7,804,000
Mortgages and long term receivables	4,843,000	5,332,000
Unamortized deferred charges, investment in associated companies and other	3,806,000	4,201,000
	$31,759,000	$29,554,000

Amortization of other assets amounted to $113,000 for the nine months ended March 31, 1976 (twelve months ended—March 31, 1976: $141,000; June 30, 1975: $76,000).

8. Bank indebtedness:

Bank indebtedness of $31,920,000 (1975—$27,102,000) arising from tobacco operations is secured by the related accounts receivable and inventories. Bank indebtedness of the major United States brewing subsidiary of $5,500,000 at March 31, 1976 is secured by the related accounts receivable.

9. Long term debt:

Long term debt consists of Sinking Fund Debentures of the Company ($27,850,000) and Carling O'Keefe Limited ($27,200,000). The remaining sinking fund requirements for the years ending March 31, 1977 through 1981 are as follows:

	1977	1978	1979	1980	1981
Rothmans of Pall Mall Canada Limited	$1,350,000	$1,600,000	$1,600,000	$1,600,000	$1,600,000
Carling O'Keefe Limited	2,263,000	3,800,000	3,800,000	3,200,000	3,200,000
	$3,613,000	$5,400,000	$5,400,000	$4,800,000	$4,800,000

The Rothmans' debentures and the Carling O'Keefe Series C, D and E debentures are payable in Canadian funds. The Carling O'Keefe Series A and B debentures are payable in either Canadian or U.S. funds at par, at the option of the holder. The Rothmans' debentures are secured by a floating charge on the Company's assets in the Provinces of Ontario and Quebec.

The Rothmans' Series B debentures were issued on February 20, 1975 under a deed of Trust and Mortgage dated December 15, 1967, as supplemented by indentures dated December 15, 1972 and February 15, 1975.

10. Minority interest in subsidiary companies:

The interest of minority shareholders in consolidated earnings or losses, before extraordinary items, was as follows:

	Nine months ended March 31 1976	Twelve months ended March 31 1976	Twelve months ended June 30 1975 (restated)
CARLING O'KEEFE LIMITED:			
Preference shares	$ 1,598,000	$ 2,132,000	$ 2,142,000
Common shares	(2,095,000)	(641,000)	(1,519,000)
	(497,000)	1,491,000	623,000
JORDAN VALLEY WINES LIMITED			
Common shares	93,000	167,000	168,000
	$ (404,000)	$ 1,658,000	$ 791,000

The minority shareholders' interest in the capital stock and retained earnings of subsidiary companies is as follows:

	March 31 1976	June 30 1975 (restated)
CARLING O'KEEFE LIMITED:		
Preference shares	$ 43,793,000	$ 43,974,000
Common shares	53,810,000	57,536,000
	97,603,000	101,510,000
JORDAN VALLEY WINES LIMITED:		
Common shares	1,714,000	3,394,000
	$ 99,317,000	$104,904,000

11. Capital stock:

AUTHORIZED—

469,889 First Preferred shares of the par value of $100 each, issuable in series
2,817,062 Second Preferred shares of the par value of $20 each
7,950,000 Common shares without nominal or par value

ISSUED—

	March 31 1976	June 30 1975
169,801 6.85% Cumulative Redeemable First Preferred shares, Series A (1975—169,889)	$ 16,980,000	$ 16,989,000
1,842,062 6⅝% Convertible Cumulative Redeemable Second Preferred shares	36,841,000	36,841,000
	53,821,000	53,830,000
4,557,928 Common shares	3,590,000	75,160,000
	$ 57,411,000	$128,990,000

SUPPLEMENTARY LETTERS PATENT:

By supplementary letters patent dated February 16, 1976, the authorized and issued capital stock of the Company was altered by:

(i) a reduction of $71,570,000 in paid-up Common share capital;

(ii) the cancellation of 30,111 Series A First Preferred shares previously purchased for cancellation, 1,007,938 Second Preferred shares and 1,950,000 Third Preferred shares previously converted into Common shares and 75,000 Third Preferred shares authorized but not issued.

The reduction in Common share capital was made in conjunction with the decision of the directors of the Company to write-off, as at June 30, 1975, the $71,570,000 excess cost of shares of Carling O'Keefe Limited over the recorded value of underlying net tangible assets at dates of acquisition. At June 30, 1975, an equivalent amount was segregated in the shareholders' equity section of the balance sheet pending final approval of the reduction in capital.

CONVERSIONS AND PURCHASES:

During the nine months ended March 31, 1976, 88 First Preferred shares with a total par value of $9,000 were purchased for cancellation at a cost of $6,000.

During the year ended June 30, 1975, 2,035 First Preferred shares were purchased for cancellation, 1,003,988 Second Preferred shares were converted into 1,003,948 Common shares and all of the 1,950,000 Third Preferred shares were converted into an equal number of Common shares.

REDEMPTION AND CONVERSION PRIVILEGES:

The Series A First Preferred shares are not redeemable before January 27, 1979, but are redeemable on or after that date at the option of the Company at a premium of $3 per share if redeemed before January 27, 1984, of $2 per share if redeemed before January 27, 1989, and of $1 per share if redeemed on or after January 27, 1989. The Company is required to purchase 5,000 of these shares in each calendar year. At March 31, 1976, 199 shares of the 1976 requirement had been acquired.

The Second Preferred shares are not redeemable before November 1, 1979, but are redeemable on or after that date at the option of the Company at par. These shares are convertible on the basis of 1 Common share for 1¼ Preferred shares converted on or before October 31, 1979. Thereafter, the Second Preferred shares will not be convertible into Common shares of the Company.

The Series A Debentures and the Series A Preferred shares were issued with warrants to purchase Common shares of the Company. The 349,970 warrants outstanding are presently exercisable at $22.63 per Common share. Depending on conversions of Second Preferred shares and date of exercise, the warrant exercise price may increase to a maximum of $23.21. After January 3, 1978, the warrants expire.

Of the authorized and unissued Common shares, 1,823,620 shares are reserved for the exercise of warrants outstanding and the conversion of Second Preferred shares.

OWNERSHIP:

Rothmans of Canada Limited presently owns 83.4% of the Company's issued Common shares as well as 14.7% of the issued Series A First Preferred shares. Rothmans of Canada has confirmed its intention to reduce its Common shareholdings to 50% at some future date.

12. Retained earnings:

Under Section 62 of the Canada Corporations Act, $9,000 of retained earnings at March 31, 1976 is designated as capital surplus on the purchase for cancellation of 88 First Preferred shares during the nine months ended March 31, 1976. By supplementary letters patent dated February 16, 1976, the $3,011,000 of capital surplus at June 30, 1975 was restored to unappropriated retained earnings.

Under the most restrictive provisions of the covenants relating to the Debentures and the Preferred shares, the Company cannot declare dividends on Common shares unless, after providing for them, consolidated retained earnings will be not less than $6,000,000 and all dividends on the Preferred shares have been declared and either paid or provided for.

13. Remuneration of directors and officers:

The aggregate direct remuneration of the thirteen directors and eleven officers (three of whom are also directors), who held their positions with the Company during the nine months ended March 31, 1976, was as follows:

		As Directors		As Officers
Nine months ended March 31, 1976:				
By the Company	(13)	$29,000	(11)	$539,000
By Carling O'Keefe	(4)	1,000	(2)	34,000
Twelve months ended June 30, 1975:				
By the Company	(11)	38,000	(11)	678,000
By Carling O'Keefe	(4)	18,000	(2)	268,000

14. Pensions:

The Company and its subsidiaries maintain a number of pension plans covering substantially all employees. The charge against earnings for pensions was $4,571,000 for the nine months ended March 31, 1976 (twelve months ended—March 31, 1976: $5,426,000; June 30, 1975: $5,085,000), including $3,619,000 (twelve months ended—March 31, 1976: $4,184,000; June 30, 1975: $3,962,000) for employees in brewing operations. The Company's policy is to fund pensions with independent trustees, as described in Note 1.

Based on recent actuarial valuations, unfunded prior service costs for brewing operations in excess of those reflected in the balance sheet are estimated at $16,000,000, of which $3,800,000 relates to vested benefits. Pension liabilities for tobacco operations are fully funded.

15. Income taxes:

Credit has not been taken for losses of the major United States brewing subsidiary which may be applied only against its future taxable income, other than credits related to reversal of deferred income taxes. At March 31, 1976, accumulated losses of approximately $23,200,000 are available to be applied against future taxable income, of which $1,700,000 can be carried forward to 1978, $2,600,000 to 1979, $9,600,000 to 1980 and $9,300,000 to 1981.

No income taxes are payable by the Irish brewing subsidiary as a result of the carry-forward of losses incurred in prior years.

16. Earnings per Common share:

Earnings per Common share for the nine and twelve months ended March 31, 1976 have been calculated on the 4,557,928 shares which were outstanding during these periods.

During the year ended June 30, 1975, a total of 2,953,988 Second and Third Preferred shares were converted into 2,953,948 Common shares. The 1975 earnings per Common share figures were calculated using the weighted average number of shares outstanding during the year (3,918,580) after giving effect to these conversions as at the termination date (September 17, 1974) of their Preferred dividend obligation.

If the above shares had been converted as at July 1, 1974, earnings per Common share for the year ended June 30, 1975 before the extraordinary charge would have been $2.67 (after the extraordinary charge, a loss of $13.03).

Assuming exercise of the outstanding warrants and conversion of the Second Preferred shares as at July 1, 1975, earnings per Common share on a fully diluted basis for the nine months ended March 31, 1976 would have been $2.05 before the extraordinary charge ($1.79 after the extraordinary charge). For the twelve months ended March 31, 1976 (assuming exercise and conversion at April 1, 1975), the comparable figures would have been $3.20 before extraordinary items (after extraordinary items, a loss of $8.28).

17. Commitments and contingent liabilities:

Rentals payable under lease agreements expiring more than three years after March 31, 1976 approximate $1,700,000 annually.

Under a long term agreement with United Breweries Limited of Copenhagen, Denmark dated March 17, 1972 Carling O'Keefe obtained access to the brewing research and technical knowledge of United Breweries together with the exclusive right to manufacture and sell brewery products under the Carlsberg and Tuborg trademarks in Canada, the United States and the Republic of Ireland. Royalties are payable based on total sales of all brewery products at rates varying with the volumes and selling prices of the products. The agreement is cancellable on twenty years' notice or earlier if certain specified conditions are not fulfilled.

Carling O'Keefe is committed to acquire, during the 1979 fiscal year, the minority interest (8.1%) in the shares of Jordan Valley Wines Limited for an amount at least equal to $2,397,000.

The Company, together with the other major Canadian cigarette manufacturers, guaranteed a minimum average price for the 1975 crop to The Ontario Flue-Cured Tobacco Growers' Marketing Board. Sales of tobacco at the Ontario auctions were completed subsequent to March 31, 1976, at an average price which was less than the guaranteed minimum price. As a result the Company is obligated to make deficiency payments totalling approximately $6,400,000 (representing approximately 25% of the total).

To ensure an adequate supply of Ontario flue-cured tobacco, the Company and the other major Canadian cigarette manufacturers have agreed to guarantee a minimum average price for the 1976 Ontario flue-cured tobacco crop.

18. Federal anti-inflation legislation:

The Company and its Canadian subsidiaries are subject to controls on prices, profits, dividends and compensation instituted by the Federal Government in the Anti-Inflation Act which became effective October 14, 1975. The Company and its subsidiaries believe they have complied with the requirements of the Act. To comply with the controls, dividends paid by the Company during the twelve months ending October 13, 1976 may not exceed the annual rates per share in effect at September 17, 1975.

Price Waterhouse & Co.
CHARTERED ACCOUNTANTS

Box 51 Toronto-Dominion Centre
Toronto, Ont. M5K 1G1
(416) 863-1133 Telex 02-2246

May 21, 1976

AUDITORS' REPORT

TO THE SHAREHOLDERS OF
ROTHMANS OF PALL MALL CANADA LIMITED:

We have examined the consolidated statements of earnings, retained earnings and changes in financial position of Rothmans of Pall Mall Canada Limited and its subsidiary companies for the nine and twelve months ended March 31, 1976 and the consolidated balance sheet as at that date. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

As described in Note 6 to the financial statements, the United States brewing operations are being re-organized including the closure of the Natick plant. No adjustment has been made to the recorded value of the Natick plant pending final disposition of the property.

In our opinion, subject to the adjustments, if any, that might be required on resolution of the matter referred to in the preceding paragraph, these consolidated financial statements present fairly the results of operations and the changes in financial position of the companies for the nine and twelve months ended March 31, 1976 and their financial position as at that date, in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change to the full cost method of accounting for oil and gas operations as explained in Note 4, on a basis consistent with that of the preceding year.

Price Waterhouse & Co.

Chartered Accountants

Ten-Year Financial Review

Operating Results (in thousands of dollars):	Twelve months ended March 31 1976	Twelve months ended June 30 1975	1974	1973
		(1)	(1)	(1)
Sales				
Tobacco	**$385,406**	$344,134	$300,889	$271,703
Brewing	**512,083**	466,456	419,949	412,603
	897,489	810,590	720,838	684,306
Excise and sales taxes	**371,416**	346,245	322,455	311,600
	526,073	464,345	398,383	372,706
Earnings				
Earnings (loss) before income taxes—				
Tobacco	**37,578**	30,648	22,267	21,207
Brewing	**5,288**	1,769	(4,054)	8,837
	42,866	32,417	18,213	30,044
Income taxes	**(20,124)**	(15,825)	(10,460)	(12,231)
Minority interest	**(1,658)**	(791)	1,289	(4,293)
Earnings before extraordinary items	**21,084**	15,801	9,042	13,520
Extraordinary items	**(73,255)**	(71,570)	772	1,902
Earnings (loss)	**(52,171)**	(55,769)	9,814	15,422
Depreciation	**14,159**	13,471	12,891	11,751
Interest expense	**9,507**	9,461	8,446	6,433
Dividends paid—				
Preferred	**3,604**	4,592	7,541	7,608
Common	**2,279**	1,910	802	—
Financial Position (in thousands of dollars):				
Working capital	**$ 72,207**	$ 86,764	$ 61,489	$ 67,240
Property, plant and equipment—net	**171,004**	157,004	154,337	155,938
Other assets	**31,759**	29,554	104,071	102,030
Total assets	**424,272**	404,355	457,438	451,926
Bank indebtedness and notes payable	**77,515**	56,162	77,597	70,433
Long term debt	**55,050**	59,639	44,873	49,707
Minority interest in subsidiaries	**99,317**	104,904	106,518	109,469
Shareholders' equity	**95,795**	88,227	150,557	149,499
Per Common Share:				
Earnings (loss)—before extraordinary items	**$ 3.84**	$ 2.90	$ 0.94	$ 3.68
—after extraordinary items	**(12.24)**	(15.36)	1.42	4.87
Dividends paid	**0.50**	0.50	0.50	—
Shareholders' equity	**9.18**	7.52	23.23	22.25
Ratios and Statistics:				
Working capital ratio	**1.48**	1.66	1.45	1.53
Capital expenditures (in thousands of dollars)	**$ 18,880**	$ 17,478	$ 18,778	$ 21,171
Number of common shares outstanding (in thousands)	**4,558**	4,558	1,604	1,604

(1) Figures for the twelve months ended June 30, 1972 to 1975 inclusive have been restated to reflect retroactive adoption of the full cost method of accounting for oil and gas operations since acquisition by a subsidiary of Carling O'Keefe Limited.

(2) Results of Carling O'Keefe Limited have been consolidated since November 1, 1969, the effective date of acquisition of a 50.1% interest in that company; accordingly, the 1970 operating results include brewing for an eight-month period only.

Twelve months ended June 30					
1972	1971	1970	1969	1968	1967
(1)		(2)			
$248,928	$223,840	$211,981	$205,871	$173,640	$166,014
404,779	396,210	249,726	–	–	–
653,707	620,050	461,707	205,871	173,640	166,014
300,431	283,633	223,558	131,125	109,860	105,609
353,276	336,417	238,149	74,746	63,780	60,405
18,141	14,107	10,195	11,930	8,475	7,712
15,757	17,428	11,557	–	–	–
33,898	31,535	21,752	11,930	8,475	7,712
(16,208)	(16,534)	(11,232)	(6,074)	(4,405)	(3,949)
(5,294)	(5,355)	(3,597)	–	–	–
12,396	9,646	6,923	5,856	4,070	3,763
(1,005)	(1,279)	141	–	–	–
11,391	8,367	7,064	5,856	4,070	3,763
11,761	9,929	6,564	1,832	1,634	1,504
5,578	6,105	5,342	3,322	1,911	1,413
7,644	7,679	5,613	526	–	–
–	–	1,200	1,600	325	–
$ 77,142	$ 92,340	$ 52,785	$ 18,739	$ 15,971	$ 12,271
144,099	119,232	119,112	9,796	9,991	8,061
96,843	106,148	152,169	32,269	12,673	3,694
429,525	410,159	420,835	104,591	79,563	69,220
57,770	33,879	40,869	25,938	28,809	32,699
53,772	58,669	63,080	14,620	15,000	–
105,976	106,070	108,632	–	–	–
142,368	139,131	139,019	45,353	22,450	22,786
$ 2.97	$ 1.23	$ 0.67	$ 3.30	$ 2.54	$ 2.89
2.34	0.43	0.76	3.30	2.54	2.89
–	–	0.75	1.00	0.25	–
17.25	14.81	14.21	15.81	14.03	17.53
1.69	2.00	1.55	1.43	1.39	1.27
$ 22,396	$ 16,276	$ 15,990	$ 1,637	$ 3,564	$ 2,010
1,600	1,600	1,600	1,600	1,600	1,300

Officers

Chairman of the Board	JOHN H. DEVLIN
President and Chief Executive Officer	ROBERT H. HAWKES, Q.C.
Vice President Marketing	ROY H. NEWTON
Vice President Administration	CAMILLE A. DENIS
Vice President Production	DANIEL DI IANNI
Vice President, General Counsel and Secretary	C. PAUL YOUNG
Vice President, Marketing Administration and Trade Services	ROBERT T. LLOYD
Vice President Sales	GORDON R. WHITE
Treasurer	HUGH R. SAMPSON, C.A.

Directors

JOEL W. ALDRED, D.F.C.(1),(2)	President Joel W. Aldred Limited, Toronto, Ontario
GEORGE E. CREBER, Q.C.(2)	President and Chief Executive Officer The Consumers' Gas Company, Toronto, Ontario
SIR FRANCIS DE GUINGAND, K.B.E., C.B., D.S.O.	Director of Companies London, England
JOHN H. DEVLIN	Chairman of the Board Rothmans of Pall Mall Canada Limited, Toronto, Ontario
ROBERT H. HAWKES, Q.C.(1)	President and Chief Executive Officer Rothmans of Pall Mall Canada Limited, Toronto, Ontario
MURRAY B. KOFFLER (2)	Chairman of the Board and Chief Executive Officer Koffler Stores Limited, Toronto, Ontario
JOHN C. LOCKWOOD	Chairman of the Board Carling O'Keefe Limited, Toronto, Ontario
GEORGE B. McKEEN	President McKeen & Wilson Ltd., Vancouver, British Columbia
RENAULT ST-LAURENT, Q.C., LL.D.	Partner St-Laurent, Monast, Walters & Vallières, Quebec City, Quebec
JOHN E. SHAFFNER (1)	Agent General for the Province of Nova Scotia in the United Kingdom Port Williams, Nova Scotia
C. PAUL YOUNG	Vice President, General Counsel and Secretary Rothmans of Pall Mall Canada Limited, Toronto, Ontario

(1) Member of the Audit Committee
(2) Member of the Compensation Committee

ROTHMANS OF PALL MALL CANADA LIMITED